

Office of Chief Counsel
Internal Revenue Service

memorandum

CC:MSR:AOK:OKL:TL-N-8071-98
ORLatrobe

date: March 8, 1999

to: Chief, Examination Division, Arkansas-Oklahoma District
Attn: Leola Casey, Senior Reviewer

from: District Counsel, Arkansas-Oklahoma District, Oklahoma City

subject: Supplemental Advisory Opinion
Calculation of Credit Election Interest Date

EIN: [REDACTED]

TYE: [REDACTED]

DISCLOSURE STATEMENT

This advice constitutes return information subject to I.R.C. § 6103. This advice contains confidential information subject to attorney-client and deliberative process privileges and if prepared in contemplation of litigation, subject to the attorney work product privilege. Accordingly, the Examination or Appeals recipient of this document may provide it only to those persons whose official tax administration duties with respect to this case require such disclosure. In no event may this document be provided to Examination, Appeals, or other persons beyond those specifically indicated in this statement. This advice may not be disclosed to taxpayers or their representatives.

This advice is not binding on Examination or Appeals and is not a final case determination. Such advice is advisory and does not resolve Service position on an issue or provide the basis for closing a case. The determination of the Service in the case is to be made through the exercise of the independent judgment of the office with jurisdiction over the case.

This is in further response to your memorandum, dated December 1, 1998, requesting our advice with respect to the above taxpayer and issue. Based upon additional consideration by our office, we are supplementing our advisory of December 23, 1998, as follows.

Facts

The facts remain as stated in the prior memorandum, which reflect those provided to us by your office. There has been no independent determination as to the facts.

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Discussion

Taxpayer initially reported an overpayment of approximately \$ [REDACTED] for its [REDACTED] tax year, which it elected to be applied against its estimated tax for the succeeding tax year, [REDACTED]. The taxpayer did not designate against which installment of estimated tax for [REDACTED] the [REDACTED] overpayment was to be applied. As a result of a subsequent examination of the taxpayer's [REDACTED] tax year, the Service determined, and the taxpayer agreed to, a deficiency in the amount of \$ [REDACTED]. The first and second installments of estimated tax for [REDACTED] were full paid from funds other than the [REDACTED] overpayment. The taxpayer requested that \$ [REDACTED] of the [REDACTED] overpayment be applied against the third installment of estimated tax for [REDACTED], due [REDACTED]. According to the facts, the balance of the overpayment was not needed to pay the fourth installment of estimated taxes for the [REDACTED] tax year, and that balance was ultimately used to pay the installment of estimated taxes due on [REDACTED].

As stated in a fax from the taxpayer's representative, [REDACTED], dated [REDACTED], the taxpayer believes that interest on the deficiency of \$ [REDACTED] for [REDACTED] should begin to run from [REDACTED], the date on which \$ [REDACTED] of the overpayment was applied to the third installment of estimated tax for [REDACTED]. Based on our review of the supplemental information you provided, which included copies of transcripts of account for the taxpayer's [REDACTED] and [REDACTED] tax years, and the Form 2220 (Underpayment of Estimated Tax by Corporations) the taxpayer filed for [REDACTED], it appears that this taxpayer's situation fits the fact pattern of *May Department Stores Co. v. United States*, 36 Fed. Cl. 680 (1996). However, as discussed below, in the instant case, interest on the deficiency for [REDACTED] does not begin to run from the third installment of estimated taxes for [REDACTED], but begins to run from the due date of the return for the taxpayer's [REDACTED] tax year.

In the instant case, the first, second and fourth installments of estimated taxes for [REDACTED] were full paid from funds other than the [REDACTED] overpayment. Only a portion of the \$ [REDACTED] overpayment (\$ [REDACTED]) was needed to avoid an addition to tax for failure to pay the [REDACTED] estimated tax under I.R.C. § 6655 for the third installment due on [REDACTED]. The balance of the overpayment (\$ [REDACTED]) exceeded the deficiency in the amount of \$ [REDACTED]. Consequently, interest on the [REDACTED] deficiency does not begin to run from the third installment of estimated tax due on [REDACTED]. However, as noted below, interest begins to run on the [REDACTED] deficiency from the due date of the return for the taxpayer's [REDACTED] tax year.

Accordingly, it is our recommendation that the interest on the [REDACTED] deficiency begins to run on the due date of the [REDACTED] return, even though the taxpayer has agreed that such deficiency interest should begin earlier.

Although the government has determined not to appeal the decision in *Sequa v. United States*, 1998 U.S. Dist. LEXIS 8556 (S.D.N.Y. June 8, 1998), a brief discussion as to the government's position with regard to such cases may be of some guidance.

In general, the government is entitled to interest on a deficiency in tax for the period that the tax was due and unpaid. I.R.C. § 6601(a); *Avon Products Inc. v. United States*, 588 F.2d 342 (2d Cir. 1978). If a deficiency in tax is determined after the taxpayer elected to credit a return overpayment against its estimated tax liability for the next succeeding year, interest will begin to accrue on the amount of the deficiency equal to the amount of the return overpayment as of the effective date of the credit elect. H.R. Rep. No. 98-432 (Part I), 98th Cong., 1st Sess. 190 (Oct. 21, 1983); see also, Rev. Rul. 88-98, 1988-2 C.B. 356. Section 413 of the Tax Reform Act of 1984 provides that overpayments of tax will be credited against the estimated income tax for the next succeeding year with full regard to Revenue Ruling 77-475, 1977-2 C.B. 476.⁴ Pub. L. No. 98-369, 98 Stat. 494. Revenue Ruling 77-475 provides:

[i]f an overpayment of income tax for a taxable year occurs on or before the due date of the first installment of estimated tax for the succeeding taxable year, the overpayment is available for credit against any installment of estimated tax for such succeeding taxable year and will be credited in accordance with the taxpayer's election.

1977-2 C.B. at 476 (emphasis added)

Accordingly, interest on the deficiency in the prior year begins to accrue on the due date of the installment of estimated tax for the succeeding taxable year against which the overpayment

⁴ In 1983, the Service revoked Revenue Ruling 77-475. Rev. Rul. 83-111, 1983-2 C.B. 245. However, in response to tremendous public criticism and expected Congressional action, the Service promulgated Revenue Ruling 84-58, 1984-1 C.B. 254, which reinstated and modified Revenue Ruling 77-475 on March 30, 1984.

was credited in accordance with the taxpayer's designation. H.R. Rep. No. 98-432 (Part I), 98th Cong., 1st Sess. 190 (Oct. 21, 1983); see also Rev. Rul. 88-98, 1988-2 C.B. 356.

Pursuant to Revenue Ruling 84-58, 1984-1 C.B. 254, which modified Revenue Ruling 77-475, the Service generally was crediting a reported overpayment of tax against the taxpayer's first installment of estimated income tax for the succeeding tax year unless the taxpayer attached a statement to its return that designated otherwise. However, in *May Department Stores Co. v. United States*, 36 Fed. Cl. 680 (1996), the Court of Federal Claims concluded that the assumption behind the default rule in Revenue Ruling 84-58 was that the taxpayer had underpaid its first installment of estimated tax for the succeeding tax year. Thus, a return overpayment will not be deemed to be credited for interest purposes to an installment of estimated tax due prior to the filing of the prior year's return if the taxpayer did not designate the particular installment of estimated tax against which to apply the return overpayment and the installments of estimated tax due prior to the filing of the prior year's return were fully paid without the application of the return overpayment. *May Department Stores Co. v. United States*, 36 Fed. Cl. 680 (1996). On August 4, 1997, the Service acquiesced in the *May Department Stores* decision. *May Department Stores Co. v. United States*, AOD CC-1997-008.⁵ As noted above, based on the supplemental information you provided, it appears that the taxpayer in the instant case fits the fact pattern set forth in *May Department Stores*.

In light of the *May Department Stores* decision, the Service has reconsidered the manner in which interest on a subsequently

⁵ The *May Department Stores* action on decision provides that,

for deficiency interest purposes, where a taxpayer does not initially designate a reported overpayment to satisfy a particular installment [of estimated tax] for the following year, and crediting of the return overpayment is not necessary to fully pay an installment of estimated tax due prior to the filing of the prior year's return, the reported overpayment will not be deemed to be credited to an installment of estimated tax due prior to the filing of the prior year's return.

May Department Stores Co. v. United States, AOD CC-1997-008 (Aug. 4, 1997).

determined deficiency is computed under I.R.C. § 6601(a) when the taxpayer makes an election to apply an overpayment to the succeeding year's estimated taxes. When a taxpayer elects to apply an overpayment to the succeeding year's estimated taxes, the overpayment is applied to unpaid installments of estimated tax due on or after the date(s) the overpayment arose, in the order in which they are required to be paid to avoid an addition to tax for failure to pay estimated tax under I.R.C. § 6655 with respect to such year.

The date the overpayment becomes a payment on account of the succeeding year's estimated tax determines the date the prior year's tax became unpaid for purposes of I.R.C. § 6601(a). Prior to that date the government has had the use of the funds with respect to the prior year's tax, and no interest is payable on the overpayment that is the subject of the taxpayer's election. See I.R.C. § 6402(b); Treasury Reg. § 301.6402-3(a)(5) & § 301.6611-1(h)(2)(vii). Interest should be charged from the point the prior year's tax is both due and unpaid. *May Department Stores Co. v. United States*, 36 Fed. Cl. 680 (1996), acq. AOD CC-1997-008 (Aug. 4, 1997); *Avon Products, Inc. v. United States*, 588 F.2d 342 (2d Cir. 1978); Rev. Rul. 88-98, 1988-2 C.B. 356.

Where the overpayment is not needed to satisfy any installment of estimated tax in the succeeding year, the overpayment would be treated as a payment of the succeeding year's income tax. Section 6513(d) provides that if any overpayment of income tax is, in accordance with I.R.C. § 6402(b), claimed as a credit against estimated tax for the succeeding tax year, such amount shall be considered as a payment of income tax for the succeeding taxable year (whether or not claimed as a credit in the return of estimated tax for such succeeding taxable year) and no claim for credit or refund of such overpayment shall be allowed for the taxable year in which the overpayment arises. See also I.R.C. § 6513(a) which provides that a payment of income tax made before the date prescribed for payment of the tax is considered paid on that date. The date prescribed for payment of tax is the time fixed for filing the return (determined without regard to any extension of time for filing the return). I.R.C. § 6151. Further, it is on this date that the overpayment is treated as a payment for purposes of computing interest on any overpayment of income taxes with respect to the succeeding year under I.R.C. § 6611(a) and (d). Thus, we conclude that the statute requires that an overpayment which the taxpayer elects to credit against estimated tax for the succeeding year must be treated as a payment against the next year's tax with an effective date no later than the due date of the next year's return.

As we stated in our prior memorandum, the deficiency interest for the [REDACTED] tax year should not run during the time that the government has use of the funds. However, since the Service disagrees in part with the decision of *Sequa*, we would add that the Service may not follow *Sequa* in all cases. Specifically, regardless of the language of *Sequa*, in cases where the overpayment from the first tax year exceeds the deficiency even after the application of a portion of the overpayment to pay any or all of the installments of estimated taxes for the succeeding tax year (which is the situation in the instant case), or none of the overpayment is needed to avoid the penalty for failure to pay the installments of estimated taxes for the succeeding tax year, it is the Service's position that interest on the subsequently determined deficiency will begin to run no later than the date on which the overpayment of the first tax year is applied to the succeeding year's tax liability which is the unextended due date of the succeeding year's income tax return. As a result of this application of the overpayment to the succeeding year's tax liability, the deficiency for the overpayment year becomes both due and unpaid and interest should begin to run from that date.

If you have any further questions with regard to the above, please feel free to contact Mr. Osmun R. Latrobe of our office at Ext 4815.

/S/ MICHAEL J. O'BRIEN

MICHAEL J. O'BRIEN
District Counsel

cc: CC:MSR:ARC(TL)
CC:MSR:ARC(LC)

Office of Chief Counsel
Internal Revenue Service

memorandum

CC:MSR:AOK:OKL:TL-N-8071-98
ORLatrobe

date: DEC 23 1998

to: Chief, Examination Division, Arkansas-Oklahoma District
Attn: Leola Casey, Senior Reviewer

from: District Counsel, Arkansas-Oklahoma District, Oklahoma City

subject: Advisory Opinion
Calculation of Credit Election Interest Date

EIN: [REDACTED]

TYE: [REDACTED]-[REDACTED]

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This is in reply to your memorandum dated December 1, 1998 (and supplemental schedule dated 12/10/98), requesting our advice with respect to the above issue and taxpayer. Our advice follows.

FACTS

According to your memorandum and supplemental schedules of payments and liabilities (attached hereto for reference), the taxpayer originally reported a tax liability of \$ [REDACTED] for the taxable year [REDACTED]. Its payments of tax resulted in an overpayment for [REDACTED] in the amount of \$ [REDACTED], which it elected to be applied to the [REDACTED] year. Because of intervening payments by the taxpayer, initially no portion of the above overpayment was needed in order to satisfy any installments for the [REDACTED] tax year.

However, as a result of an examination of the [REDACTED] year an additional tax liability in the amount of \$[REDACTED] was determined and agreed. The taxpayer has now requested that \$[REDACTED] of the overpayment be applied to the [REDACTED] period. This would leave an overpayment carryover from [REDACTED] in the amount of \$[REDACTED]. Because of intervening payments by the taxpayer, the remaining \$[REDACTED] is not needed to be applied to the taxpayer's liabilities until the [REDACTED] installment (even after the prior periods were adjusted for additional tax liabilities per examination). It should be noted that your memorandum states that the taxpayer does not want to apply the balance until the due date of the [REDACTED] return. The taxpayer's comments attached to your memorandum indicate an intent to apply the balance to the [REDACTED] installment. We would suggest that you clarify these dates before finalizing the computation.

For the purpose of this memorandum our office has adopted the facts as they were provided to us in your memorandum. We have not made an independent review of the transcripts to verify the payments or the dates. If you have any questions in this regard, we recommend that the computations be reviewed by the appropriate personnel. If further legal issues should arise in that review, please let us know so that we may address them.

ISSUE

From what dates is deficiency interest to be computed where there is an application of a prior overpayment to a later deficiency determined for the overpayment year?

DISCUSSION

The answer to your inquiry is resolved by the application of Rev. Rul. 88-98, 1988-2 C.B.356. That revenue ruling adopted the holding of the court in the case of Avon Products, Inc. v. United States, 588 F.2d 342 (2d Cir. 1978). This holding has been further expanded in the case of Sequa Corp. v. United States, 97-1 USTC ¶ 50,317.

In Avon and the subsequent revenue ruling it was determined that, where a taxpayer elected to have an overpayment applied to a subsequent installment payment and it was later determined that a deficiency was due for the prior period, that interest would run only from the date of the subsequent installment to which the overpayment had been applied. The theory for this application is that interest runs on a tax liability only when it is due and unpaid. Although the deficiency determined an additional tax liability was due for the prior period, the amount of the deficiency had been in the government's control until it was

applied to the later installment and therefore the interest should run from the date of the application to the installment, rather than the date of the deficiency (of course, assuming that the original overpayment was adequate to cover the determined deficiency).

In the case of Sequa Corp. v. United States, 97-1 USTC ¶ 50,317, the facts are quite analogous to those in Avon, but rather than the overpayment being applied to the immediately following installment, in Sequa the overpayment was not needed until several periods later due to intervening payments by the taxpayer. This case appears to be directly analogous to the facts in the inquiry which you have at hand. The logic of the Sequa rationale is identical to that of Avon: the government had use of the overpayment during the period until its actual application and thus no interest would accrue until that time. Of course, since the taxpayer had been elected to apply the overpayment to a later period, no interest was due to the taxpayer either. Rev. Rul. 88-89, 198-2 C.B. 356, 357. The Service has determined not to appeal the decision in Sequa.

Based upon the above, it is our opinion that interest owed by the taxpayer should run from the date that the overpayment was actually applied and the government no longer had use of the funds, rather than from the initial date that the deficiency in tax was due.

If we may be of any further assistance in the above matter, please feel free to contact Mr. Osmun R. Latrobe of our office at 405-297-4815.

/S/ MICHAEL J. O'BRIEN

MICHAEL J. O'BRIEN
District Counsel

Attachments:
Supplemental Schedules

cc: CC:MSR:ARC(TL)
CC:MSR:ARC(LC)
CC:FS:PROC
Attn: Deirdre James